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Senate Subcommittee on Surface Transportation and Merchant Marine
Committee on Commerce, Science and Transportation

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Madam Chairwoman and members of the subcommittee, thank you for the opportunity to testify before you today. My name is Terry Whiteside and I represent many farm producer groups, including the Montana Wheat and Barley Committee, the Idaho Wheat Commission, the Idaho Barley Commission, and many other shipper organizations. The Montana Wheat and Barley Committee is a wheat and barley producer check-off organization representing all Montana farm producers. The Idaho Wheat Commission and Idaho Barley Commission represent all of the Idaho wheat and barley producers, respectively.

However, I am here today in my capacity as a member of the Executive Committee of the Alliance for Rail Competition (ARC). ARC is a diverse coalition of shippers that was formed one year ago for the sole purpose of developing and promoting a consensus-based plan for achieving rail-to-rail competition. Concerns about railroad market power span all rail dependent shippers and industries. ARC's growing membership reflects the diversity of those interests: agriculture, coal, chemicals, consumer products, industrial products, minerals and petrochemicals, and some of the trade associations that represent many of these groups, as well as port and industrial development authorities.

In your invitation to testify, you specifically requested comments on issues concerning the reauthorization of the STB, including the appropriate funding level necessary for the Board to carry out its statutory duties, the Administration's proposal to fund the Board through user fees, and the activities of the Board since its inception on January 1, 1996.

Although the Alliance for Rail Competition focuses its efforts on promoting rail-to-rail competition, I'd like to state for the record that we oppose the Administration's proposal to fund the Surface Transportation Board entirely with user fees. Today, only $2 million of the STB's $16 million budget is funded through user fees, but those fees are already so extraordinarily high that they discourage shippers from filing a complaint at all, particularly smaller shippers that do not have the resources to support filing and attorney's fees, not to mention the amount of time it takes to bring such an action to conclusion.

While issues about funding and user fees are important, they do not address the heart of the real issue at hand: whether the current rail market is being appropriately managed within the existing regulatory parameters. The shipping community would answer that query with a resounding "no."

When the Staggers Rail Act was passed in 1980, shippers understood that regulation of railroads was to be curtailed, and instead, "to the maximum extent possible," competition was to ensure that rail rates were reasonable. The spirit of the law has been undermined by narrow regulatory interpretations.

Upon its inception in January 1996, the new Surface Transportation Board was faced with the products of the ICC's regulatory policies: a drastically consolidated rail market place and grave concerns from the shipping community about the growing potential for monopoly rate abuse and deteriorating service levels. But the new STB also had a choice. At that time, the STB could have chosen to protect the shipping community from growing rail market dominance and begin to balance the scales between shippers and the railroads by promoting a competitive rail market—either by modifying existing regulatory rulemakings or requesting changes to its statutory authority—or it could continue the record of its predecessor, approving virtually any proposed merger and defining the success of its decisions based upon the success of its lawyers in the appeals court.

Based on its record, it is clear what choice the STB made. Not only did the STB approve the largest parallel merger of two railroads in history in the name of "efficiency" –a merger that has produced service deterioration unprecedented in the annals of railroad history – but it also handed down the now-legendary " bottleneck" decision and continues to wonder why shippers are reluctant to bring "competitive access" cases despite significant law and precedent that was promulgated under the ICC.

The Alliance for Rail Competition believes that a continuation of the status quo is unacceptable, and that changes to existing regulatory policies must be legislated to ensure that the STB will begin to promote competition as originally directed and intended by the 1980 Staggers Act. Therefore, ARC urges this committee to reauthorize the STB for no more than two years, and only with changes that will promote the reemergence of competitive forces within the rail industry. ARC believes that a two-year reauthorization is necessary in order for the Congress to subsequently assess the STB's progress in promoting competitive forces, and continue to explore longer-term solutions that will bring market-driven rail-to-rail competition back to the rail industry.

As I've noted before, the members of the Alliance for Rail Competition believe that the only real long-term solution to their concerns about rates and service quality is free market competition.

But how do you achieve free market competition in an industry that has only five major Class I railroads—two of which are in the West, and three in the East until Conrail is absorbed by Norfolk Southern and CSX? ARC believes that there must be short- and long-term solutions that gradually bring competitive concepts into the existing regulatory structure and eventually promote free-market competition. ARC began its work by attempting to define what a railroad customer's rights should be. Within a competitive rail marketplace, ARC believes railroad customers should have the right to:

Receive timely, efficient, and even innovative service;
Have access to competitive service and rates;
Route their shipments between any two points, and at rates determined by a competitive market;
Receive full rights of redress for service and/or rate complaints and expect those complaints to be resolved in a timely manner and have legal rights accorded other businesses against anti-competitive conduct, including rights under the antitrust laws;
Access a rail system that is both efficient and safe for the environment and the community;
Fairly share the liabilities associated with the movement of their goods; and
Access adequate capacity to handle reasonable traffic growth.

Today, railroad customers do not have the right to any of these things—and in fact, based on the way existing regulations have been interpreted, they barely have the <u>right</u> to anything at all. That is why the Alliance for Rail Competition believes that bringing competition to the rail industry will require both a short-term and a long-term plan. While we continue to search for answers in the long-term, we are making several recommendations to this subcommittee for how Congress can begin to bring competition back into the railroad industry in the short-term. They are as follows:

Competitive Reciprocal Switching and Terminal Trackage Rights – The Congress should provide increased rights to competition through reciprocal switching and terminal trackage rights, affirmatively requiring the grant of these rights within an established distance of existing interchanges in order to promote rail-to-rail competition.

Under the current statute, the STB is empowered to grant trackage rights and reciprocal switching in a terminal or for a "reasonable distance" outside of a terminal, when it finds such remedies to be "practicable" and "in the public interest," or where reciprocal switching is necessary to provide "competitive rail service." These rights, which are set forth at 49 U.S.C. 11102, have been in the statute for a number of years and were broadened in the Staggers Act.

Despite these broad and seemingly pro-competitive provisions, the agency, by rule and policy, has drastically restricted the application of these rights. The agency's rules, promulgated in 1984, have been interpreted in the *Midtec* decision (1984) and later cases to require the shipper to prove competitive " abuse" in order to qualify for competitive relief, and raise numerous other barriers. In fact, a shipper has never won a case brought under the current rules, and the precedent set by the half-dozen or so cases decided to date establish tests that no shipper could possibly meet.

ARC recommends that legislation reversing the agency's approach should be adopted. The agency should have an affirmative obligation to establish competition via reciprocal switching and trackage rights at or within a reasonable distance of an existing interchange between rail carriers, and the " abuse" test established by the agency should be specifically abolished.

A substantially broadened right to competition via reciprocal switching or trackage rights would provide the benefits of competition to a number of shippers, where such shippers are at or within a reasonable distance of another carrier. Because such trackage rights would be limited to rail service at or within a reasonable distance of where two carriers already interchange cars and locomotives, such competitive rail service would be operationally feasible.

Trackage rights are frequently used by carriers: indeed, as part of the UP/SP merger, the UP/SP granted the BNSF of 4,000 miles of trackage rights over its system. ARC's recommendations would require the agency to interpret the statute in a pro-competitive, rather than a restrictive, manner, where relatively short-distance trackage rights or switching can provide competitive opportunities

<u>Shipper's Right to Competitive Routings and Reasonable Rates Over Bottlenecks</u> – The Congress should restore to shippers the right to competitive rail routing through existing interchanges to encourage rates produced by the competitive market, and should require the provision of reasonable rates in a timely manner over rail bottlenecks.

In the agency's 1996 "bottleneck" decision, the STB ruled that, in most situations, a rail carrier with a "bottleneck" monopoly can lawfully foreclose alternate and competitive rail routings by another carrier, where the "bottleneck" carrier can provide origin to destination service.

Consider the example of a shipper that needs to move his goods 1,000 miles and is served by both Carrier A and Carrier B at his destination, but only Carrier A at his origin. Carrier B interchanges with Carrier A and can provide alternative and competitive rail service over 900 miles of the total movement from the interchange to the destination:

Carrier A

Carrier A

Origin O

Destination D

Interchange I

Carrier B

In the above example, even though Carrier B can provide competition over a large portion of the movement, the STB ruled that Carrier A can simply refuse to interchange with Carrier B for transportation from the interchange to the destination. The STB also ruled that it would not even consider a shipper's challenge to the lawfulness of a rate for this "bottleneck" segment. This means that there can be no review of the reasonableness of a rate for the 100 miles controlled by Carrier A in the above example.

The STB's bottleneck decision should be reversed legislatively, to restore to shippers the right to route over competitive routings at rates produced by the competitive market thorough existing interchanges, and to clarify that the STB can establish a maximum reasonable rate over a bottleneck segment. These changes would ensure that the monopoly bottleneck carrier couldn't take advantage of its pricing power to foreclose competition over the competitive portion of the route. They would permit competition to flourish where it can. These changes would not bring a return to the old "open routing" system, whereby carriers were required to keep even inefficient interchanges open and were required to charge the same rate over all possible routes. Rather, only interchanges already utilized by the carriers would qualify, and rates over various routes would vary as costs and competition demand. Where a carrier controls a bottleneck, its pricing initiative would only be subject to current statutory restrictions against charging unreasonably high rates where there is no effective competition.

Finally, the Congress should also reverse the bottleneck decision to clarify that the STB can prospectively prescribe a maximum reasonable rate so that the rate is available to a shipper immediately upon expiration of the shipper's contract.

Competition and Reasonable Rates – The Congress should require that significant weight be given to the level of rates produced in the presence of rail-to-rail competition for shipments of the same or similar commodities when reasonable rates are prescribed where effective competition does not exist. Congress should also adopt objective, easy to apply rate standards for agricultural shippers, and direct the STB to consider similar standards be considered for other non-coal shippers.

Under the STB's current so-called "Constrained Market Pricing" standards, the STB requires shippers to hypothesize the rates that would be produced if a new railroad were built from the ground up to serve the complaining shipper in competition with the existing carrier. This exercise in "imagining" a new railroad – the calculation of so-called "Stand Alone Cost" – requires massive amounts of evidence as to such things as the cost of land acquisition for this new "stand alone" carrier, the cost of track, locomotives, operating costs, etc. Hundreds of thousands of dollars can be spent in legal and consultant fees on this exercise in competitive hypothesis.

Yet, throughout the process of determining what a maximum rate should be to a captive shipper, the STB never considers what that same carrier is already charging shippers for movements of the same commodity where rail-to-rail competition actually exists.

This “never-never land” of regulation should be injected with a dose of reality.

Congress should require the STB, in determining what rate should be charged where there is an absence of competition, to consider like rates that are actually charged where there is the presence of competition. The STB should give significant weight to this evidence, though other types of evidence, such as evidence on stand alone cost current utilized by the Board, could be considered as well.

Finally, ARC recognizes that agricultural shippers, and especially the smaller agricultural shippers, have particular difficulties in bringing maximum reasonable rate complaints, given their size and the circumstances of their transportation. Maximum rate standards currently applicable to such shippers are not useful, since they fail to provide objective and easy-to-determine and apply results. The Congress should establish such standards, particularly for small agricultural shippers, and should direct the STB to consider similar standards for other non-coal shippers.

<u>Competition and Rail Mergers</u> – The Congress should require the STB, in evaluating and overseeing rail merger transactions, to adopt conditions that would encourage rail-to-rail competition.

The current statute requires the STB, in considering the merger of Class I rail carriers, to consider the effect of the transaction upon competition in the affected region or in the national rail system. However, the STB has interpreted this directive to mean that it must only consider competitive harm in evaluating or overseeing a rail merger. Thus, the STB will not use its conditioning power to expand or encourage competitive opportunities when it reviews rail mergers. At the same time, the STB has tended to define “harm” in extremely narrow terms, thus restricting the scope of any relief.

The Congress should change this approach. Instead of a negative focus upon competitive harm narrowly defined, the focus should be on opportunities to expand and foster competitive options. In the currently pending Norfolk Southern/CSX/Conrail transaction, the two acquiring carriers agreed to expand potential competition in a number of areas that lacked competitive rail options before. But under the STB's current approach, an expansion of competitive opportunities could probably not have been ordered by the agency if the railroads themselves had not agreed to it. This makes no sense.

Congress should provide that, in both evaluating and overseeing rail merger and similar rail control transactions, the STB should be required to adopt conditions that would encourage rail-to-rail competition where such competition does not presently exist.

Improvements in Rail Service and Reform of Claims for Ineffective Rail Service – The Congress should eliminate current time period limitations on directed rail service orders, and protect shippers' rights to effective service during periods when directed rail service orders are in effect. The Congress also should allow shippers the option of seeking redress for ineffective rail service before either the STB or the courts, at the shipper's election.

Under the current statute, if the STB finds that there is a rail emergency, it is authorized to grant relief for an initial thirty days, and can extend that relief for no more than 240 additional days.

The current UP/SP service crisis already shows the inadequacy of this provision. The STB has declared that there is a transportation emergency, and has already extended its directed service order for the full statutory period, without any confirmation that the crisis will be resolved by that time. In addition, there is some question about the extent of the agency's statutory authority to grant certain relief, particularly to permit shippers who are under contract to the carrier experiencing service failures to access other carriers during the emergency.

The Congress should remove the current time period limitation on directed rail service orders, and should clarify that the Board may take all actions necessary, including the suspension of contract obligations in the case of service failures, to cure the cause of the service crisis and provide relief to shippers during the service crisis.

In addition, the Congress should clarify that shippers who have been damaged by a carrier's service failures may seek redress, including all damages flowing from the carrier's failure to provide service, in either the courts or the STB, at the shipper's election. Senior STB personnel have already stated that the agency is not equipped to handle a substantial number of cases involving the

UP's service meltdown, and shippers should not be required to adjudicate their damage claims before an agency that cannot quickly and efficiently resolve them.

<u>Increasing Rail-to-Rail Competition from Short Line Carriers</u> – The Congress should make unlawful any restrictions by Class I carriers on short line carriers from interchanging with other carriers.

Since the passage of the Staggers Act, short line carriers have become an important part of the nation's rail transportation system. ARC believes that Congress should make statutory changes that would enable short line carriers to facilitate increased competition in the rail industry.

Short line carriers are often "captive" to a particular Class I carrier. Frequently, however, this captivity is not due to the fact that a particular short line connects solely to one Class I carrier, but rather is the result of restrictions placed upon the short line at the time that the newly-established Class III is "spun off" by the Class I parent. Specifically, when a planned short line can interchange with a carrier besides the Class I parent, restrictions are placed on the short line at the time of its spin-off that prevent the short line from interchanging with any carrier other than the Class I parent. Shippers served by the short line, then, are held captive. The Class I parent obtains the benefits of the short line spin-off, including lower labor costs, without jeopardizing its hold on its captive shippers.

This is poor public policy. ARC believes that Congress should make unlawful any restrictions by Class I carriers that prevent short line carriers from interchanging with other carriers. A legislative prohibition on such restrictions would free both shippers and short lines from the control of a particular Class I carrier, bringing the potential for increased traffic to the short line, and the potential for increased competition to the shipper.

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In addition, the Alliance for Rail Competition supports the concepts included in S. 1429, the Railroad Shipper Protection Act when viewed in concert with the pro-competitive policy changes I have just outlined. We applaud Senators Jay Rockefeller, Conrad Burns and Byron Dorgan for their leadership in providing an initial framework within which the shipping community could forward additional recommendations for reform, such as outlined in ARC's six-point plan. We will continue to work with them and others in both the House and Senate, to begin to move the rail industry toward a pro-competitive environment.

Congress has taken a look at many other industries that have been characterized by a monopoly or oligopoly market structure and has seen it necessary and appropriate to introduce competitive balances for the sake of national policy. Indeed, this week, Secretary of Agriculture Dan Glickman has indicated the Administration's concern about concentration in the meat packing industry in which 82% of the industry is controlled by just 4 packing companies. Further, the Department of Justice and the Pentagon are preparing to fight the proposed merger between Lockheed Martin and Northrop Grumman because the merger would leave only three major defense contractors to compete for the Pentagon's business, and the Pentagon doesn't think that's enough.

Yet, we have seen no real action to address similar issues in the railroad industry. In this national railroad industry, five mega carriers generate 95% of the gross ton-miles and 94% of the revenue. Two western carriers generate 92% of the gross ton-miles and 90% of the revenues. Four of these carriers handle over 90% of the U.S. coal movements. Three of these carriers control over 70% of the grain movement.

In other industries of national importance, Congress has moved to introduce competition as the best means for ensuring consumer and customer protections. The shipping community—of which as many as 1/3 or more of us are captive to only one railroad—is here today to ask you to bring competition to the rail industry as the best means of protecting our collective economic competitiveness.

Rail shippers, their customers and the U.S. economy cannot stand business as usual' at the STB for another 3 years without changes to protect the ever-increasing number of captive shippers.

For the record, characterizing such changes as "reregulatory," as the railroads have done, would require that no regulatory system exist at all. That clearly is not the case as we testify before you today about the reauthorization of the regulatory body empowered to oversee the railroad industry. ARC is interested in promoting market-based competition as a long-term replacement for regulation, and in order to achieve that end, existing regulations must be reformed to encourage the gradual re-emergence of competition.

Clearly, there are areas where the STB itself can make immediate improvements within the parameters of authority already granted by existing statutes. To date, however, STB decisions have demonstrated either an unwillingness or inability of this body to include the legitimate measurement of competition in its deliberations. It is for this reason that the Alliance for Rail Competition believes that these issues must be addressed legislatively. ARC will continue to advocate the passage of legislation that will encourage competition in the rail market place in both the short- and long-term.

Madam Chairwoman, I'd like to thank you once again for the opportunity to testify before you today about these important issues. I'd also like to request that both my written and oral statements today be made a part of this hearing record. In addition, I would like to submit for the record a copy of ARC's filing before the Surface Transportation Board in the Ex Parte 575 proceeding, which includes my written statement and that of Dr. Alfred Kahn.

Thanks for your consideration, and I'd be happy to answer any questions that you may have.